

ASSURANCE OF DISCONTINUANCE
5280 FINANCIAL GROUP AND TROY L. BOWEN

STATE OF COLORADO ATTORNEY GENERAL'S OFFICE CONSUMER PROTECTION SECTION	
In re: 5280 FINANCIAL GROUP, INC., and TROY L. BOWEN, as president and individually Respondents: 5280 FINANCIAL GROUP, INC., and TROY L. BOWEN, as president and individually	
JOHN W. SUTHERS, Attorney General JAN MICHAEL ZAVISLAN, Deputy Attorney General ANDREW P. McCALLIN, First Assistant Attorney General OLIVIA C. DEBLASIO, Assistant Attorney General 1525 Sherman Street, 7 th Floor Denver, CO 80203 (303) 866-5079 Fax: (303) 866-4916 Email: libby.deblasio@state.co.us	
ASSURANCE OF VOLUNTARY COMPLIANCE AND DISCONTINUANCE WITH 5280 FINANCIAL GROUP, INC. AND TROY L. BOWEN	

This Assurance of Voluntary Compliance and Discontinuance ("Assurance") is entered into between the State of Colorado, ex rel. John W. Suthers, Attorney General, and Respondent 5280 Financial Group, Inc. and Respondent Troy L. Bowen (collectively, "Respondents"). Respondent Bowen is a mortgage broker licensed by the Colorado Division of Real Estate, mortgage broker license number LMB100009168. This Assurance is entered into pursuant to the Attorney General's powers under § 6-1-110(2), C.R.S. (2007), and is being agreed to by the parties in lieu of the Attorney General filing a complaint against Respondents for the conduct described below.

ASSURANCE OF DISCONTINUANCE
5280 FINANCIAL GROUP AND TROY L. BOWEN

I. PARTIES

1. John W. Suthers is the duly elected Attorney General for the State of Colorado and has express jurisdiction to investigate and to prosecute violations of the Colorado Consumer Protection Act ("CCPA"), § 6-1-101, et seq., C.R.S. (2007).

2. 5280 Financial Group, Inc. is a mortgage broker company owned and operated by Troy L. Bowen, who is a licensed mortgage broker with the state of Colorado. Respondents' principal place of business is 20361 E. 48th Place in Denver, Colorado 80249. Respondents advertise and sell mortgages, including option ARM loans, for residential properties in Colorado. Respondent Bowen is the sole owner of 5280 Financial and the sole loan officer for the company.

3. Respondents understand and agree that this Assurance shall apply to 5280 Financial Group and any future loan officers it may employ, as well as any principals, officers, directors, agents, employees, representatives, successors, affiliates, subsidiaries, assigns, contractors and any person acting on behalf of 5280 Financial Group. Respondents further understand and agree that this Assurance also applies to Respondent Bowen, personally, so long as he is affiliated with 5280 Financial Group or any other mortgage brokerage firm in which he owns an interest or over which he has control.

II. FACTUAL BACKGROUND

4. Colorado Attorney General John W. Suthers has conducted an investigation pursuant to the CCPA into the advertising and business practices of Respondents.

ASSURANCE OF DISCONTINUANCE
5280 FINANCIAL GROUP AND TROY L. BOWEN

5. Respondents marketed and sold “option ARM” and other non-traditional or hybrid loan products between 2006 and 2008. An “option ARM” loan typically allows the borrower to choose from a few monthly payment options, including: a) an amortizing payment of interest and principal, b) an interest-only payment, or c) a minimum payment that is calculated using a low teaser rate.

6. Respondent Bowen conceived of and approved of 5280 Financial’s advertising and marketing of loan products, including option ARM loans. Specifically, Respondent Bowen has drafted and approved all of 5280 Financial’s ads that appear in the Post-News Mortgage Marketplace and on the company’s Web site located at <http://www.5280financialgroupinc.com/index.html>. Respondent Bowen conceived of and continues to direct the practices and policies of 5280 Financial.

7. Respondents advertise throughout the year in the Post-News Mortgage Marketplace and sell various loan programs, but have consistently advertised option ARM loans since at least 2006.

8. In 2006, Respondent Bowen created and approved of a series of 5280 Financial ads that ran in the Post-News Mortgage Marketplace. One of the ads, which ran in late 2006 and typifies the other ads that Respondents have run, states: “5 Year Fixed Mortgages Starting at 1.75%, 3.65% APR”; “10 Year Fixed Mortgages Starting at 2.95%, 4.843% APR”; and “30 Year Fixed Mortgage Starting at 5.625%, 5.881% APR.” In the ad, Respondents make no distinction among the loans, such as indicating that the first two advertised loans are adjustable rate mortgages. In reality the “5 Year Fixed Mortgages

ASSURANCE OF DISCONTINUANCE
5280 FINANCIAL GROUP AND TROY L. BOWEN

Starting at 1.75%” represents an adjustable rate mortgage and the advertised rate is not the interest rate for the life of the loan but rather the rate for the first month and the rate used to calculate the first five years’ minimum payment.

9. Respondents’ ad also gives an Annual Percentage Rate (“APR”) with each advertised rate that may not be representative of the fully indexed rate for the last three years, pursuant to federal regulations. Respondents’ ad fails to state that the APR is subject to increase after consummation.

10. Further, Respondents’ ad provides an asterisk next to the “5 Year Fixed at 1.75%” loan which references a chart of what a monthly “payment” would be based on three different loan amounts. If the loan is \$150,000, for example, the payment is listed as \$223.03. The chart fails to disclose the fully amortized and interest only payments, the current fully-indexed rate, and negative amortization feature of the loan, which are material elements of this loan.

11. Respondents purport to make meaningful disclosures in the ads. The disclosures that reference the “payment,” are presented in small print and stated that the payment amounts are “based on 1% opt. arm. Min. mnth payment, 1 year of repayments, 480 mnth, 5280 FGI rebate, 20% equity, WAC.” In other ads that Respondent Bowen drafted and approved, there is no mention of “1% opt. arm. Min. mnth payment.”

12. Since 2006, Defendants altered their advertising of option ARM loans. In September 2007, Defendants altered their print advertisements to read in part, “Five Year Fixed Payment 1.0%, 5.32% APR”; “30 Year Fixed Mortgage 5.375%, 5.612% APR”; 40

ASSURANCE OF DISCONTINUANCE
5280 FINANCIAL GROUP AND TROY L. BOWEN

Year Payment 1.90%, 5.49% APR.” Inserting the word “Payment” provides no more meaningful information than inserting the phrase “Starting at” before the advertised rate. The phrase “fixed payment” next to the advertised rate does not disclose what the rate represents. The loan still includes a “payment” calculation based on identified loan amounts without any disclosure of the negative amortization feature.

13. In November 2007, Respondents deleted any mention of interest rates in their ads and instead provided only the chart that compares “loan amounts” to “payments.” But, again, Respondents failed to disclose that the “payments” were only the minimum monthly payments, that the chart represents an option ARM loan, and that making only the payment listed in the chart will result in negative amortization.

14. Once potential borrowers call the number listed on the ads and speak with Respondent Bowen, they learn that the low advertised rate and payment has nothing to do with the interest rate of any loan and that by making only the advertised payment borrowers would experience negative amortization on the loan.

15. After borrowers learn of the negative amortization feature, and if they are no longer interested in the option ARM loan, Respondents use the opportunity to offer borrowers other loan programs.

16. Respondents’ advertisements fail to disclose that the APR may increase after consummation of the loan and the rate at which the interest is accruing.

17. The State contends that these advertising and sales practices violate the CCPA, including § 6-1-105(1), C.R.S. (2007) and § 38-40-105, C.R.S. (2007).

III. DEFINITIONS

18. “CHARM Booklet” means the Consumer Handbook on Adjustable-Rate Mortgages published by the Federal Reserve Board.

19. “Clear and Conspicuous” or “Clearly and Conspicuously” as used herein shall mean that the information must be disclosed with equal prominence and in close proximity to the term or phrase that triggers the clear and conspicuous disclosure requirement.

20. “Close Proximity” shall mean that the information to be disclosed must be immediately adjacent or above the term or phrase that triggers the disclosure requirement.

21. “Credit score” means a numerical value that ranks a borrower’s credit risk based upon a statistical evaluation of the borrower’s credit history as determined by the Fair Isaac Corporation.

22. “Fixed Rate Mortgage” means a mortgage that has a fixed interest rate for the entire term of the mortgage.

23. “Easily Readable Print” shall mean that the information to be disclosed shall be readable without the aid of magnification or the assistance of other devices. A disclosure shall not be deemed easily readable if it is located in a footnote, in small print, on the side or back of the advertising material, or in an unreadable font size or typeface.

24. “Equal Prominence” shall mean that the information to be disclosed must have the same contrast and be in the same font size and typeface as the term or phrase that triggers the disclosure requirement.

ASSURANCE OF DISCONTINUANCE
5280 FINANCIAL GROUP AND TROY L. BOWEN

25. “Loan to Value ratio” means the relationship between the loan amount and the value of the property (the lower of the appraised value or sales price), expressed as a percentage of the property’s value.

26. “Nontraditional Mortgage” means any residential mortgage loan product that allows the borrower to defer repayment of principal or interest. This includes all interest only products, payment option ARMs and negative amortization mortgages, with the exception of reverse mortgages and home equity lines of credit, other than a simultaneous second-lien loan.

27. “A Traditional 3/1, 5/1 or 7/1 ARM” shall mean a hybrid ARM, with a fixed rate for an initial period, but then changes at regular intervals after this initial period based on an index and margin. For example, a Traditional 5/1 ARM has a fixed rate for five years and then after the fifth year changes each year thereafter. The change in interest rate is based on changes in an index rate, such as the rate for Treasury securities, the London Interbank Offer Rate or the Cost of Funds Index plus a margin.

IV. **UNDERTAKINGS**

28. Respondents enter this Assurance as a compromise and settlement of the State’s allegations herein. This Assurance shall not be considered an admission of violation for any purpose. Respondents assure the State that 5280 Financial and Bowen and any future loan officers they may employ, as well as any principals, officers, directors, agents, employees, representatives, successors, affiliates, subsidiaries, contractors, assigns and any person acting

ASSURANCE OF DISCONTINUANCE
5280 FINANCIAL GROUP AND TROY L. BOWEN

on their behalf shall comply with the CCPA as now constituted or as may hereafter be amended in conducting business in the state of Colorado.

A. Disclosures Provided to Borrowers Applying for Variable Rate or Non-Traditional Loan Products.

29. In discussing any loan product with a consumer, Respondents shall not represent that the introductory rate is the applicable interest rate for longer than the introductory period. Respondents shall affirmatively disclose the following:

- a) The precise term of any introductory rate;
- b) The interest rate the consumer will likely pay after the expiration of the introductory rate;
- c) The consumer's estimated monthly payment for each payment option upon the expiration of that introductory rate; and
- d) The maximum monthly payment the consumer may have to pay under the loan.

Additionally, Respondents shall not represent the introductory rate as the "interest rate" for purposes of the Good Faith Estimate.

30. Respondents shall not provide any consumer with a TILA disclosure based solely on the introductory rate without simultaneously providing the consumer with a TILA disclosure based upon the composite of the rate in effect during the introductory period and the rate that is the basis of the loan for the remainder of the term. Copies of both TILA disclosures shall be part of the consumer's loan file.

ASSURANCE OF DISCONTINUANCE
5280 FINANCIAL GROUP AND TROY L. BOWEN

31. Twenty four (24) hours before closing, Respondents must verify that the borrower has been provided a current copy of the CHARM booklet. If one has not been provided, Respondents shall give a copy of a current CHARM Booklet to the borrower twenty four (24) hours before closing on any ARM loan product. A current copy of the CHARM Booklet is attached hereto as **Exhibit A**. Respondents shall go to www.FederalReserve.Gov to obtain the most current copy of the CHARM Booklet. The CHARM Booklet will be the borrower's to keep.

32. When Respondents have verified that the borrower has received the CHARM booklet and has kept it for at least 24 hours, the borrower and Respondents shall sign and date a Confirmation of Receipt Form, attached hereto as **Exhibit B**.

33. Respondents shall adhere to the duty of good faith and fair dealing found at § 12-61-904.5, CRS (2007), follow the reasonable inquiry standards set forth at § 12-61-904.5(1)(b), CRS, the reasonable, tangible net benefit standards set forth at § 12-61-904.5(1)(a), CRS and any rules adopted by the Division of Real Estate pertaining to these standards.

B. Advertising of Mortgage Loan Products.

34. The advertising standards set forth in this subsection IV(B) shall apply to all advertisements, marketing or promotional materials issued by Respondents, including but not limited to, newspaper and magazine advertisements, direct mail, flyers, brochures, emails, faxes, websites, telemarketing, billboards and banner or pop-up advertising that is disseminated electronically ("advertising material").

ASSURANCE OF DISCONTINUANCE
5280 FINANCIAL GROUP AND TROY L. BOWEN

1. Requirements Regardless of Future Revisions to Regulation Z.

35. When creating any advertising material for any mortgage loan products, Respondents shall follow the advertising standards set forth in Regulation Z, 12 CFR § 226.24, and the staff commentary, including any future revisions thereto to either.

36. The following terms shall apply to Respondents' advertising material regardless of any revisions that may be made to Regulation Z:

- a.) Respondents shall not advertise any Nontraditional Mortgages;
- b.) Respondents shall not advertise an interest rate lower than the rate at which interest is accruing on the loan;
- c.) Use of the term "fixed" may only refer to a Fixed Rate Mortgage;
- d.) Advertising material for loans featuring no closing costs, no payments for a set time period, no document loans or reduced documentation or that income need not be verified shall also contain Clear and Conspicuous disclosures that such features will cause the borrower to finance a greater amount or pay a higher interest rate, if that is the case.
- e.) Any advertising material that Respondents run which offer free appraisal or no appraisal fees must Clearly and Conspicuously state the conditions for receiving the free appraisal. For example, if the borrower must pay for the appraisal at the time of appraisal and the Respondents reimburse or credits the appraisal fee to the borrower at a later time, and only if the loan closes, then the advertising material must state as such.

ASSURANCE OF DISCONTINUANCE
5280 FINANCIAL GROUP AND TROY L. BOWEN

2. Advertising Standards Pending Revisions to Regulation Z.

37. The following terms shall govern Respondent's advertising of rates and payments.

These terms shall take effect upon the execution of this Assurance. The Federal Reserve Board has proposed revisions to Regulation Z that would apply to the advertising of rates and payments. See 73 Fed. Reg. 1672, 1722 – 1724 (January 9, 2008) (proposed new rule found at 12 CFR 226.24). Upon enactment of new rules regarding the advertisement of rates and payments, Respondents shall follow Regulation Z as revised and need not follow standards set forth below.

38. When advertising the rate for a loan, Respondents may advertise a rate based either on: (1) a Fixed Rate Mortgage; or (2) a traditional 3/1, 5/1 or 7/1-year ARM.

39. When advertising the rate for a Fixed Rate Mortgage, Respondents shall satisfy the following requirements:

- a.) Respondents must have verifiable evidence that the rate advertised was actually available at the time of dissemination of the advertising material; and
- b.) The advertising material must disclose in Close Proximity to the rate and in Easily Readable Print at least the following criteria, if applicable, that must be satisfied for a borrower to obtain the rate:
 - i.) The period of time over which the Fixed Rate Mortgage is amortized;
 - ii.) Whether or not the mortgage will come due with an unpaid balance that requires the borrower to pay the remaining principal balance at a date

ASSURANCE OF DISCONTINUANCE
5280 FINANCIAL GROUP AND TROY L. BOWEN

certain and, if so, what the payment amount will be (“balloon payment”)

and the date the payment will be due;

iii.) The loan amount;

iv.) The Loan-to-Value ratio, using that term;

v.) The minimum Credit Score;

vi.) The buy down required; and

vii.) The amount of any prepayment penalty.

40. When advertising the rate for a traditional 3/1, 5/1 or 7/1 ARM, Respondents shall satisfy the following requirements:

- a.) Respondents must have verifiable evidence that the rate advertised was actually available at the time of dissemination of the advertising material;
- b.) The advertising material must Clearly and Conspicuously disclose the APR for the loan and, if the advertising material also discloses an initial rate, then the advertising material must Clearly and Conspicuously state the term during which this initial rate will apply.
- c.) If the rate will increase after the initial term, the advertising material must disclose in Close Proximity to the initial rate and in Easily Readably Print that the new rate will be based on an index plus a margin; and
- d.) The advertising material must disclose in Close Proximity to the rate and in Easily Readable Print at least the following criteria, if applicable, that must be satisfied for a borrower to obtain the rate:

ASSURANCE OF DISCONTINUANCE
5280 FINANCIAL GROUP AND TROY L. BOWEN

- i.) The loan amount;
- ii.) The Loan-to-Value ratio, using that term;
- iii.) The minimum Credit Score; and
- iv.) The buy down required;
- v.) Whether the loan includes a balloon payment and, if so, the amount and due date of the balloon payment; and
- vi.) The amount of any prepayment penalty.

41. When advertising the amount of a payment on a loan, Respondents shall satisfy the following requirements:

- a.) Respondents must have verifiable evidence that the payment amount advertised was actually available at the time of dissemination of the advertising material;
- b.) The payment amount may be based only on a Fixed Rate Mortgage;
- c.) The advertising material must disclose in Close Proximity to the payment amount and in Easily Readable Print at least the following criteria, if applicable, that must be satisfied for a borrower to obtain the payment:
 - i.) The rate, including the APR, using that term;
 - ii.) The period of time over which the Fixed Rate Mortgage is amortized;
 - iii.) Whether the loan includes a balloon payment and, if so, the amount and due date of the balloon payment;
 - iv.) The loan amount;

ASSURANCE OF DISCONTINUANCE
5280 FINANCIAL GROUP AND TROY L. BOWEN

- v.) The Loan-to-Value ratio, using that term;
- vi.) The minimum Credit Score;
- vii.) The buy down required; and
- viii.) The amount of any prepayment penalty.

d.) If the payment amount advertised does not include an escrow for taxes or insurance, a Clear and Conspicuous disclosure shall be made in Close Proximity to the to the payment amount that it does not include taxes and insurance.

42. If all of the interest rates advertised in the same advertising material are based on the same criteria, the advertising material need contain only one disclosure.

V. ENFORCEMENT

43. A violation of any of the terms of this Assurance shall constitute a prima facie violation of the CCPA in accordance with § 6-1-110(2), C.R.S. (2007). Upon a violation of any terms of this Assurance by Respondents, the Attorney General shall be entitled to file a civil action under the CCPA in any court of competent jurisdiction and to seek an injunction or other appropriate order from such court to enforce the provisions of this Assurance.

44. In addition to any remedies provided under the CCPA, the Attorney General will also be entitled to apply for and seek from a court of competent jurisdiction an order converting this Assurance into a permanent injunction against Respondents as if the parties had fully litigated all issues contained herein, upon a showing by the Attorney General's Office of a violation by Respondents of this Assurance. In such event, Respondents agree to waive any and all defenses and counterclaims they may have had to such an action, except as

ASSURANCE OF DISCONTINUANCE
5280 FINANCIAL GROUP AND TROY L. BOWEN

to claims or defenses related to the alleged violation of this Assurance or as to the need for injunctive relief.

45. This Assurance shall not be construed to affect the rights of any private party to pursue remedies pursuant to § 6-1-113, C.R.S. (2007), or under any other statutes through claims or actions in common law.

46. The obligations set forth in this Assurance are continuing and apply jointly to 5280 Financial Group and Bowen.

47. Nothing in this Assurance shall be construed to release claims held by any other government authority.

48. Pursuant to § 6-1-110(2), C.R.S. (2007), this Assurance shall be a matter of public record.

49. This Assurance may be executed in one or more counterparts, each of which shall be deemed to be an original, but which together shall constitute the Assurance.

50. The person who signs this Assurance in a representative capacity for either Respondents warrants that he or she is duly authorized to do so. Respondents acknowledge that they have had a full opportunity to review this Assurance and consult with legal counsel regarding same. Respondents agree and represent that they have read and understand this Assurance, that they accept the legal consequences involved in signing it and that there are no other representations, agreements or understandings between Respondents and the State that are not stated in writing herein.

ASSURANCE OF DISCONTINUANCE
5280 FINANCIAL GROUP AND TROY L. BOWEN

51. Respondents and their principals, officers, directors, agents, employees, representatives, successors, affiliates, subsidiaries, assigns, loan officers, contractors and any person acting on behalf of Respondents agree to cooperate with all investigations and other proceedings that the State may bring to enforce the terms of this Assurance. Included within this cooperation agreement is the obligation to:

- a) Produce documents, records, electronic records or any other tangible things in response to a subpoena or other written request issued by the State; or
- b) Accept a subpoena from the State without the need for service of process.

52. Any notices, complaints or other documents required by this Assurance (including any request or subpoena) shall be sent to the following individuals at the address, email or fax set forth below:

To Respondents at:

20361 E. 48th Place
Denver, CO 80249
Email: tbowen@5280financialgroupinc.com
Fax: 303.375.9520
Phone: 303-375-9530

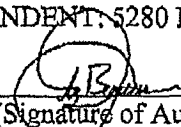
To The State at:

Olivia C. DeBlasio
Assistant Attorney General
Consumer Fraud Unit
Consumer Protection Section
1525 Sherman Street – 7th Floor
Denver, CO 80203
Email: libby.deblasio@State.CO.US
Fax: (303) 866-4916
Phone: (303) 866-5079

ASSURANCE OF DISCONTINUANCE
5280 FINANCIAL GROUP AND TROY L. BOWEN

Dated: 7.3.08

RESPONDENT: 5280 Financial Group, Inc.

By: 
(Signature of Authorized Representative)

TROY BOWEN - OWNER
(Please print name and title)

Date: 7.3.08

RESPONDENT: Troy L. Bowen

By: 
(Signature)

TROY BOWEN - OWNER
(Please print name and title)

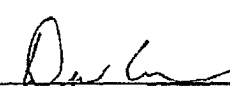
Dated: _____

JOHN W. SUTHERS
Attorney General

OLIVIA C. DEBLASIO, ESQ.
Assistant Attorney General
Consumer Protection Section

Dated: 7/7/08

APPROVED AS TO FORM:
DAN CARR, Esq.


DAN CARR, ESQ.
Counsel for Respondents
Dill Dill Carr Stonbraker &
Hutchings, PC
455 Sherman St. Ste. 300
Denver, CO 80203

ASSURANCE OF DISCONTINUANCE
5280 FINANCIAL GROUP AND TROY L. BOWEN

Dated: _____

RESPONDENT: 5280 Financial Group, Inc.

By: _____
(Signature of Authorized Representative)

(Please print name and title)

Date: _____

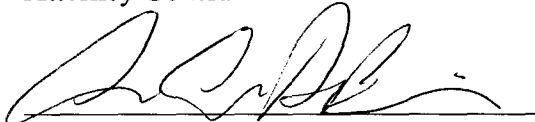
RESPONDENT: Troy L. Bowen

By: _____
(Signature)

(Please print name and title)

Dated: 7/7/2008

JOHN W. SUTHERS
Attorney General



OLIVIA C. DEBLASIO, ESQ.
Assistant Attorney General
Consumer Protection Section

Dated: _____

APPROVED AS TO FORM:
DAN CARR, Esq.

DAN CARR, ESQ.
Counsel for Respondents
Dill Dill Carr Stonbraker &
Hutchings, PC
455 Sherman St. Ste. 300
Denver, CO 80203

EXHIBIT A



The Federal Reserve Board

Consumer Handbook on **Adjustable-Rate Mortgages**

Interest Rate





Adjustable-rate mortgages (ARMs) are loans with interest rates that change. ARMs may start with lower monthly payments than fixed-rate mortgages, but keep the following in mind:

- Your monthly payments could change. They could go up—sometimes by a lot—even if interest rates don’t go up. See page 20.
- Your payments may not go down much, or at all—even if interest rates go down. See page 11.
- You could end up owing more money than you borrowed—even if you make all your payments on time. See page 22.
- If you want to pay off your ARM early to avoid higher payments, you might have to pay a penalty. See page 24.

You need to compare features of ARMs to find the one that best fits your needs. See the Mortgage Shopping Worksheet on page 2.

This handbook explains how ARMs work and discusses some of the issues that borrowers may face. It includes ways to reduce the risks and gives some pointers about advertising and other ways you can get information from lenders and other trusted advisers. Important ARM terms are defined in a glossary. And the Mortgage Shopping Worksheet can help you ask the right questions and figure out whether an ARM is right for you. Ask lenders to help you fill out the worksheet so you can get the information you need to compare mortgages.

Mortgage Shopping Worksheet

Ask your lender or broker to help you fill out this worksheet.

Name of lender or broker and contact information
Mortgage amount
Loan term (e.g., 15 years, 30 years)
Loan description (e.g., fixed rate, 3/1 ARM, payment-option ARM, interest-only ARM)
Basic Features for Comparison
Fixed-rate mortgage interest rate and annual percentage rate (APR) (For graduated-payment or stepped-rate mortgages, use the ARM columns.)
ARM initial interest rate and APR How long does the initial rate apply?
What will the interest rate be after the initial period?
ARM features How often can the interest rate adjust?
What is the index and what is the current rate? (See chart on page 8.)
What is the margin for this loan?
Interest-rate caps What is the periodic interest-rate cap?
What is the lifetime interest-rate cap? How high could the rate go?
How low could the interest rate go on this loan?
What is the payment cap?
Can this loan have negative amortization (that is, increase in size)?
What is the limit to how much the balance can grow before the loan will be recalculated?
Is there a prepayment penalty if I pay off this mortgage early?
How long does that penalty last? How much is it?
Is there a balloon payment on this mortgage?
If so, what is the estimated amount and when would it be due?
What are the estimated origination fees and charges for this loan?
Monthly Payment Amounts
What will the monthly payments be for the first year of the loan?
Does this include taxes and insurance? Condo or homeowner's association fees? If not, what are the estimates for these amounts?
What will my monthly payment be after 12 months if the index rate... ...stays the same?
...goes up 2%?
...goes down 2%?
What is the most my minimum monthly payment could be after 1 year?
What is the most my minimum monthly payment could be after 3 years?
What is the most my minimum monthly payment could be after 5 years?

[illegible]

What Is an ARM?

An adjustable-rate mortgage differs from a fixed-rate mortgage in many ways. With a fixed-rate mortgage, the interest rate stays the same during the life of the loan. With an ARM, the interest rate changes periodically, usually in relation to an index, and payments may go up or down accordingly.

Shopping for a mortgage is not as simple as it used to be. To compare two ARMs with each other or to compare an ARM with a fixed-rate mortgage, you need to know about indexes, margins, discounts, caps on rates and payments, negative amortization, payment options, and recasting (recalculating) your loan. You need to consider the maximum amount your monthly payment could increase. Most important, you need to know what might happen to your monthly mortgage payment in relation to your future ability to afford higher payments.

Lenders generally charge lower initial interest rates for ARMs than for fixed-rate mortgages. At first, this makes the ARM easier on your pocketbook than a fixed-rate mortgage for the same loan amount. Moreover, your ARM could be less expensive over a long period than a fixed-rate mortgage—for example, if interest rates remain steady or move lower.

Against these advantages, you have to weigh the risk that an increase in interest rates would lead to higher monthly payments in the future. It's a trade-off—you get a lower initial rate with an ARM in exchange for assuming more risk over the long run. Here are some questions you need to consider:

- Is my income enough—or likely to rise enough—to cover higher mortgage payments if interest rates go up?
- Will I be taking on other sizable debts, such as a loan for a car or school tuition, in the near future?
- How long do I plan to own this home? (If you plan to sell soon, rising interest rates may not pose the problem they do if you plan to own the house for a long time.)
- Do I plan to make any additional payments or pay the loan off early?

Lenders and Brokers

Mortgage loans are offered by many kinds of lenders—such as banks, mortgage companies, and credit unions. You can also get a loan through a mortgage broker. Brokers “arrange” loans; in other words, they find a lender for you. Brokers generally take your application and contact several lenders, but keep in mind that brokers are not required to find the best deal for you unless they have contracted with you to act as your agent.

How ARMs Work: The Basic Features

Initial rate and payment

The initial rate and payment amount on an ARM will remain in effect for a limited period of time—ranging from just 1 month to 5 years or more. For some ARMs, the initial rate and payment can vary greatly from the rates and payments later in the loan term. Even if interest rates are stable, your rates and payments could change a lot. If lenders or brokers quote the initial rate and payment on a loan, ask them for the annual percentage rate (APR). If the APR is significantly higher than the initial rate, then it is likely that your rate and payments will be a lot higher when the loan adjusts, even if general interest rates remain the same.

The adjustment period

With most ARMs, the interest rate and monthly payment change every month, quarter, year, 3 years, or 5 years. The period between rate changes is called the *adjustment period*. For example, a loan with an adjustment period of 1 year is called a 1-year ARM, and the interest rate and payment can change once every year; a loan with a 3-year adjustment period is called a 3-year ARM.

Loan Descriptions

Lenders must give you written information on each type of ARM loan you are interested in. The information must include the terms and conditions for each loan, including information about the index and margin, how your rate will be calculated, how often your rate can change, limits on changes (or *caps*), an example of how high your monthly payment might go, and other ARM features such as negative amortization.

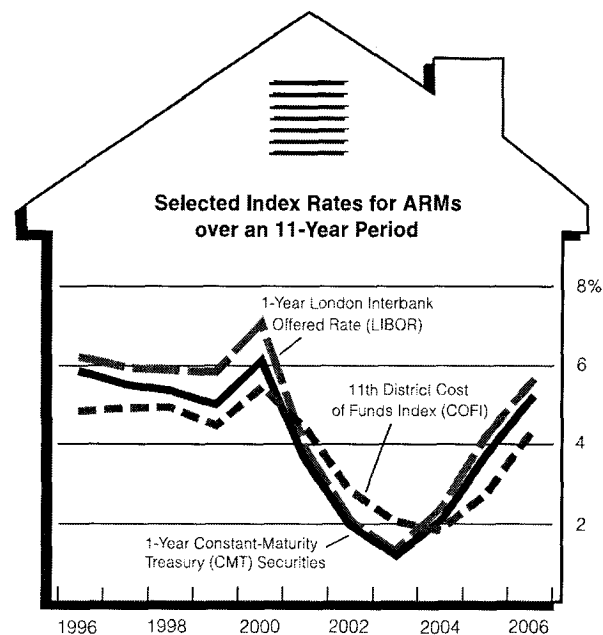
The index

The interest rate on an ARM is made up of two parts: the index and the margin. The index is a measure of interest rates generally, and the margin is an extra amount that the lender adds. Your payments will be affected by any caps, or limits, on how high or low your rate can go. If the index rate moves up, so does your interest rate in most circumstances, and you will probably have to make higher monthly payments. On the other hand, if the index rate goes down, your monthly payment could go down. Not all ARMs adjust downward, however—be sure to read the information for the loan you are considering.

Lenders base ARM rates on a variety of indexes. Among the most common indexes are the rates on 1-year constant-maturity Treasury (CMT) securities, the Cost of Funds Index (COFI), and the London Interbank Offered Rate (LIBOR). A few lenders use their own cost of funds as an index, rather than using other indexes. You should ask what index will be used, how it has

fluctuated in the past, and where it is published—you can find a lot of this information in major newspapers and on the Internet.

To help you get an idea of how to compare different indexes, the following chart shows a few common indexes over an 11-year period (1996–2006). As you can see, some index rates tend to be higher than others, and some change more often. But if a lender bases interest-rate adjustments on the average value of an index over time, your interest rate would not change as dramatically.



The margin

To determine the interest rate on an ARM, lenders add a few percentage points to the index rate, called the *margin*. The amount of the margin may differ from one lender to another, but it is

usually constant over the life of the loan. The *fully indexed rate* is equal to the margin plus the index. If the initial rate on the loan is less than the fully indexed rate, it is called a *discounted index rate*. For example, if the lender uses an index that currently is 4% and adds a 3% margin, the fully indexed rate would be

Index	4%
+ Margin	3%
<hr/>	
Fully indexed rate	7%

If the index on this loan rose to 5%, the fully indexed rate would be 8% (5% + 3%). If the index fell to 2%, the fully indexed rate would be 5% (2% + 3%).

Some lenders base the amount of the margin on your credit record—the better your credit, the lower the margin they add—and the lower the interest you will have to pay on your mortgage. In comparing ARMs, look at both the index and margin for each program.

No-Doc/Low-Doc Loans

When you apply for a loan, lenders usually require documents to prove that your income is high enough to repay the loan. For example, a lender might ask to see copies of your most recent pay stubs, income tax filings, and bank account statements. In a no-doc or low-doc loan, the lender doesn't require you to bring proof of your income, but you will usually have to pay a higher interest rate or extra fees to get the loan. Lenders generally charge more for no-doc/low-doc loans.

Interest-rate caps

An interest-rate cap places a limit on the amount your interest rate can increase. Interest caps come in two versions:

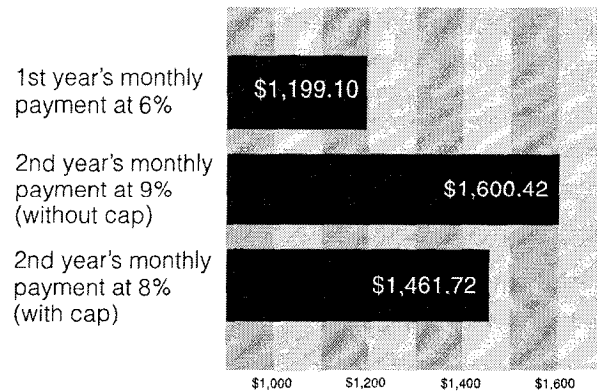
- *periodic adjustment caps*, which limit the amount the interest rate can adjust up or down from one adjustment period to the next after the first adjustment, and
- *lifetime caps*, which limit the interest-rate increase over the life of the loan. By law, virtually all ARMs must have a lifetime cap.

Periodic adjustment caps

Let's suppose you have an ARM with a periodic adjustment interest-rate cap of 2%. However, at the first adjustment, the index rate has risen 3%. The following example shows what happens.

Examples in This Handbook

All examples in this handbook are based on a \$200,000 loan amount and a 30-year term. Payment amounts in the examples do not include taxes, insurance, condominium or home-owner association fees, or similar items. These amounts can be a significant part of your monthly payment.



Difference in 2nd year between payment with cap and payment without = \$138.70 per month

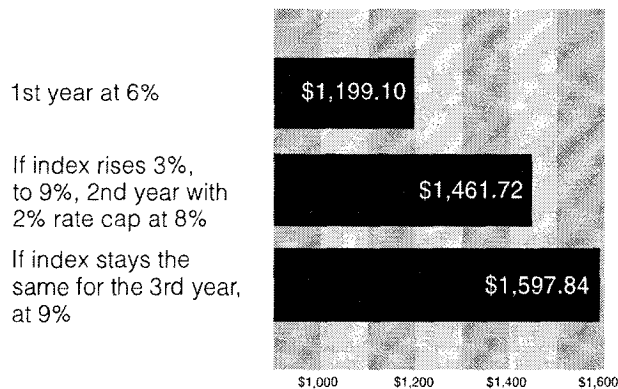
In this example, because of the cap on your loan, your monthly payment in year 2 is \$138.70 per month lower than it would be without the cap, saving you \$1,664.40 over the year.

Some ARMs allow a larger rate change at the first adjustment and then apply a periodic adjustment cap to all future adjustments.

A drop in interest rates does not always lead to a drop in your monthly payments. With some ARMs that have interest-rate caps, the cap may hold your rate and payment below what it would have been if the change in the index rate had been fully applied. The increase in the interest that was not imposed because of the rate cap might carry over to future rate adjustments. This is called *carryover*. So at the next adjustment date, your payment might increase even though the index rate has stayed the same or declined.

The following example shows how carryovers work. Suppose the index on your ARM increased 3% during the first year.

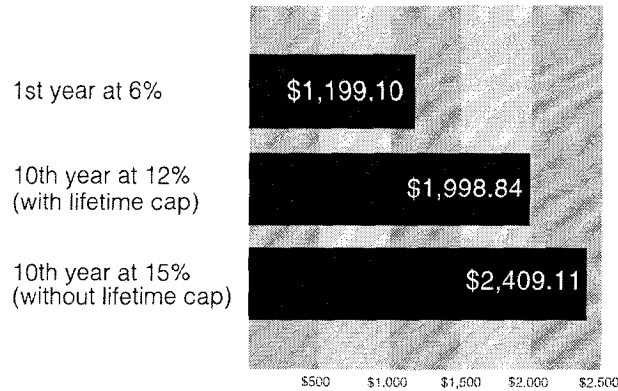
Because this ARM limits rate increases to 2% at any one time, the rate is adjusted by only 2%, to 8% for the second year. However, the remaining 1% increase in the index carries over to the next time the lender can adjust rates. So when the lender adjusts the interest rate for the third year, the rate increases by 1%, to 9%, even if there is no change in the index during the second year.



In general, the rate on your loan can go up at any scheduled adjustment date when the lender's standard ARM rate (the index plus the margin) is higher than the rate you are paying before that adjustment.

Lifetime caps

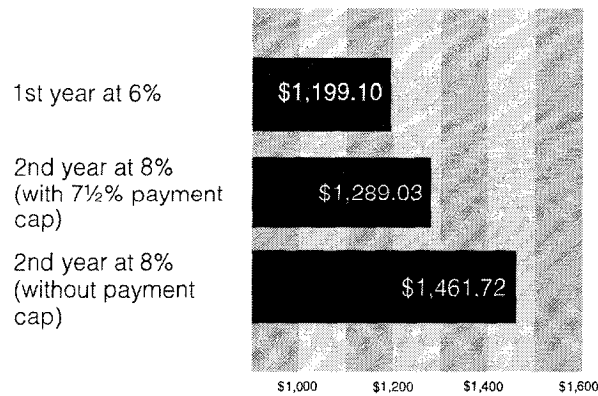
The next example shows how a lifetime rate cap would affect your loan. Let's say that your ARM starts out with a 6% rate and the loan has a 6% lifetime cap—that is, the rate can never exceed 12%. Suppose the index rate increases 1% in each of the next 9 years. With a 6% overall cap, your payment would never exceed \$1,998.84—compared with the \$2,409.11 that it would have reached in the tenth year without a cap.



Payment caps

In addition to interest-rate caps, many ARMs—including payment-option ARMs—limit, or cap, the amount your monthly payment may increase at the time of each adjustment. For example, if your loan has a payment cap of $7\frac{1}{2}\%$, your monthly payment won't increase more than $7\frac{1}{2}\%$ over your previous payment, even if interest rates rise more. For example, if your monthly payment in year 1 of your mortgage was \$1,000, it could only go up to \$1,075 in year 2 ($7\frac{1}{2}\%$ of \$1,000 is an additional \$75). Any interest you don't pay because of the payment cap will be added to the balance of your loan. A payment cap can limit the increase to your monthly payments but also can add to the amount you owe on the loan. (This is called *negative amortization*, a term that is explained on page 22.)

Let's assume that your rate changes in the first year by 2 percentage points but your payments can increase no more than $7\frac{1}{2}\%$ in any one year. The following graph shows what your monthly payments would look like.



Difference in monthly payment = \$172.69

While your monthly payment will be only \$1,289.03 for the second year, the difference of \$172.69 each month will be added to the balance of your loan and will lead to negative amortization.

Some ARMs with payment caps do not have periodic interest-rate caps. In addition, as explained below, most payment-option ARMs have a built-in recalculation period, usually every 5 years. At that point, your payment will be recalculated (lenders use the term *recast*) based on the remaining term of the loan. If you have a 30-year loan and you are at the end of year 5, your payment will be recalculated for the remaining 25 years. The payment cap does not apply to this adjustment. If your loan balance has increased, or if interest rates have risen faster than your payments, your payments could go up a lot.

Types of ARMs

Hybrid ARMs

Hybrid ARMs often are advertised as 3/1 or 5/1 ARMs—you might also see ads for 7/1 or 10/1 ARMs. These loans are a mix—or a hybrid—of a fixed-rate period and an adjustable-rate period. The interest rate is fixed for the first few years of these loans—for example, for 5 years in a 5/1 ARM. After that, the rate may adjust annually (the 1 in the 5/1 example), until the loan is paid off. In the case of 3/1 or 5/1 ARMs

- the first number tells you how long the fixed interest-rate period will be and
- the second number tells you how often the rate will adjust after the initial period.

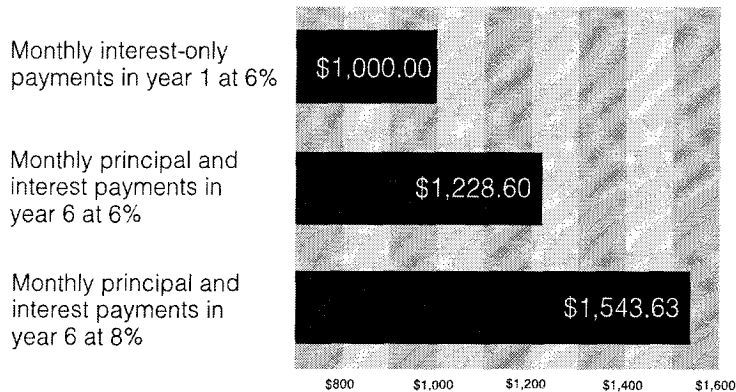
You may also see ads for 2/28 or 3/27 ARMs—the first number tells you how long the fixed interest-rate period will be, and the second number tells you the number of years the rates on the loan will be adjustable. Some 2/28 and 3/27 mortgages adjust every 6 months, not annually.

Interest-only ARMs

An interest-only (I-O) ARM payment plan allows you to pay only the interest for a specified number of years, typically between 3 and 10 years. This allows you to have smaller monthly payments for a period of time. After that, your monthly payment will increase—even if interest rates stay the same—because you must start paying back the principal as well as the interest each

month. For some I-O loans, the interest rate adjusts during the I-O period as well.

For example, if you take out a 30-year mortgage loan with a 5-year I-O payment period, you can pay only interest for 5 years and then you must pay both the principal and interest over the next 25 years. Because you begin to pay back the principal, your payments increase after year 5, even if the rate stays the same. Keep in mind that the longer the I-O period, the higher your monthly payments will be after the I-O period ends.



Payment-option ARMs

A payment-option ARM is an adjustable-rate mortgage that allows you to choose among several payment options each month. The options typically include the following:

- *a traditional payment of principal and interest*, which reduces the amount you owe on your mortgage. These payments are based on a set loan term, such as a 15-, 30-, or 40-year payment schedule.

- *an interest-only payment*, which pays the interest but does not reduce the amount you owe on your mortgage as you make your payments.
- *a minimum (or limited) payment* that may be less than the amount of interest due that month and may not reduce the amount you owe on your mortgage. If you choose this option, the amount of any interest you do not pay will be added to the principal of the loan, **increasing the amount you owe and your future monthly payments**, and increasing the amount of interest you will pay over the life of the loan. In addition, if you pay only the minimum payment in the last few years of the loan, you may owe a larger payment at the end of the loan term, called a *balloon payment*.

The interest rate on a payment-option ARM is typically very low for the first few months (for example, 2% for the first 1 to 3 months). After that, the interest rate usually rises to a rate closer to that of other mortgage loans. Your payments during the first year are based on the initial low rate, meaning that if you only make the minimum payment each month, it will not reduce the amount you owe and it may not cover the interest due. The unpaid interest is added to the amount you owe on the mortgage, and your loan balance increases. This is called *negative amortization*. This means that even after making many payments, you could owe more than you did at the beginning of the loan. Also, as interest rates go up, your payments are likely to go up.

Payment-option ARMs have a built-in recalculation period, usually every 5 years. At this point, your payment will be recalculated (lenders use the term *recast*) based on the remaining term of the loan. If you have a 30-year loan and you are at the end of year 5, your payment will be recalculated for the remaining 25

years. If your loan balance has increased because you have made only minimum payments, or if interest rates have risen faster than your payments, your payments will increase each time your loan is recast. At each recast, your new minimum payment will be a fully amortizing payment and any payment cap will not apply. This means that your monthly payment can increase a lot at each recast.

Lenders may recalculate your loan payments before the recast period if the amount of principal you owe grows beyond a set limit, say 110% or 125% of your original mortgage amount. For example, suppose you made only minimum payments on your \$200,000 mortgage and had any unpaid interest added to your balance. If the balance grew to \$250,000 (125% of \$200,000), your lender would recalculate your payments so that you would pay off the loan over the remaining term. It is likely that your payments would go up substantially.

More information on interest-only and payment-option ARMs is available in the Federal Reserve Board's brochure titled *Interest-Only Mortgage Payments and Payment-Option ARMs—Are They for You?*

Consumer Cautions

Discounted interest rates

Many lenders offer more than one type of ARM. Some lenders offer an ARM with an initial rate that is lower than their fully indexed ARM rate (that is, lower than the sum of the index plus the margin). Such rates—called discounted rates, start rates, or teaser rates—are often combined with large initial loan fees, sometimes called *points*, and with higher rates after the initial discounted rate expires.

Your lender or broker may offer you a choice of loans that may include “discount points” or a “discount fee.” You may choose to pay these points or fees in return for a lower interest rate. But keep in mind that the lower interest rate may only last until the first adjustment.

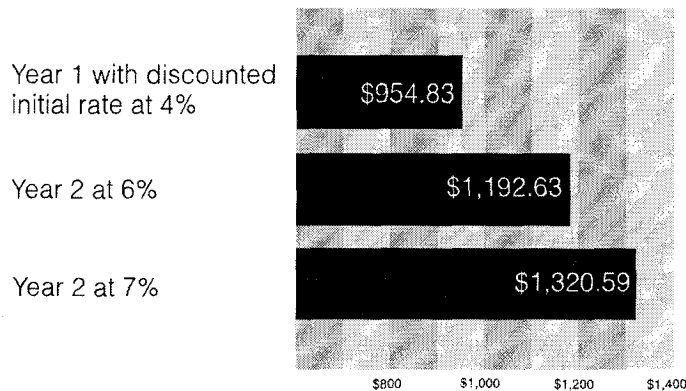
If a lender offers you a loan with a discount rate, don’t assume that means that the loan is a good one for you. You should carefully consider whether you will be able to afford higher payments in later years when the discount expires and the rate is adjusted.

Here is an example of how a discounted initial rate might work. Let’s assume that the lender’s fully indexed one-year ARM rate (index rate plus margin) is currently 6%; the monthly payment for the first year would be \$1,199.10. But your lender is offering an ARM with a discounted initial rate of 4% for the first year. With the 4% rate, your first-year’s monthly payment would be \$954.83.

With a discounted ARM, your initial payment will probably remain at \$954.83 for only a limited time—and any savings during the discount period may be offset by higher payments over the remaining life of the mortgage. If you are considering a discount ARM, be sure to compare future payments with those for a fully indexed ARM. In fact, if you buy a home or refinance using a deeply discounted initial rate, you run the risk of payment shock, negative amortization, or prepayment penalties or conversion fees.

Payment shock

Payment shock may occur if your mortgage payment rises sharply at a rate adjustment. Let's see what would happen in the second year if the rate on your discounted 4% ARM were to rise to the 6% fully indexed rate.



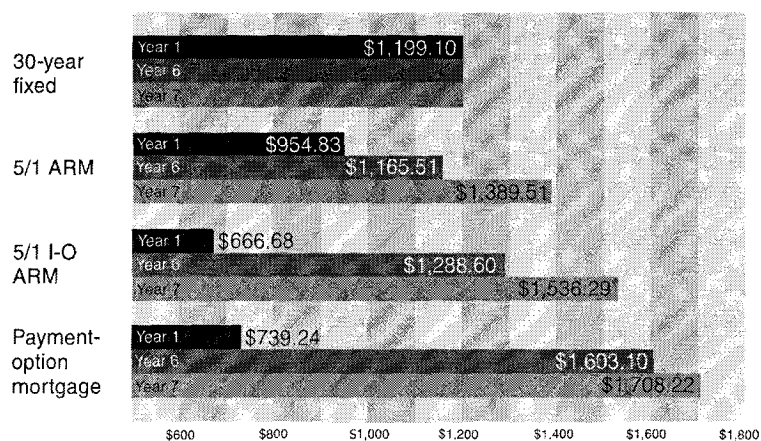
As the example shows, even if the index rate were to stay the same, your monthly payment would go up from \$954.83 to \$1,192.63 in the second year.

Suppose that the index rate increases 1% in one year and the ARM rate rises to 7%. Your payment in the second year would be \$1,320.59.

That's an increase of \$365.76 in your monthly payment. You can see what might happen if you choose an ARM because of a low initial rate without considering whether you will be able to afford future payments.

If you have an interest-only ARM, payment shock can also occur when the interest-only period ends. Or, if you have a payment-option ARM, payment shock can happen when the loan is recast.

The following example compares several different loans over the first 7 years of their terms; the payments shown are for years 1, 6, and 7 of the mortgage, assuming you make interest-only payments or minimum payments. The main point is that, depending on the terms and conditions of your mortgage and changes in interest rates, ARM payments can change quite a bit over the life of the loan—so while you could save money in the first few years of an ARM, you could also face much higher payments in the future.



Negative amortization—When you owe more money than you borrowed

Negative amortization means that the amount you owe increases even when you make all your required payments on time. It occurs whenever your monthly mortgage payments are not large enough to pay all of the interest due on your mortgage—the unpaid interest is added to the principal on your mortgage, and you will owe more than you originally borrowed. This can happen because you are making only minimum payments on a payment-option mortgage or because your loan has a payment cap.

For example, suppose you have a \$200,000, 30-year payment-option ARM with a 2% rate for the first 3 months and a 6% rate for the remaining 9 months of the year. Your minimum payment for the year is \$739.24, as shown in the previous graph. However, once the 6% rate is applied to your loan balance, you are no longer covering the interest costs. If you continue to make minimum payments on this loan, your loan balance at the end of the first year of your mortgage would be \$201,118—or \$1,118 more than you originally borrowed.

Because payment caps limit only the amount of payment increases, and not interest-rate increases, payments sometimes do not cover all the interest due on your loan. This means that the unpaid interest is automatically added to your debt, and interest may be charged on that amount. You might owe the lender more later in the loan term than you did at the beginning.

A payment cap limits the increase in your monthly payment by deferring some of the interest. Eventually, you would have to

repay the higher remaining loan balance at the interest rate then in effect. When this happens, there may be a substantial increase in your monthly payment.

Some mortgages include a cap on negative amortization. The cap typically limits the total amount you can owe to 110% to 125% of the original loan amount. When you reach that point, the lender will set the monthly payment amounts to fully repay the loan over the remaining term. Your payment cap will not apply, and your payments could be substantially higher. You may limit negative amortization by voluntarily increasing your monthly payment.

Be sure you know whether the ARM you are considering can have negative amortization.

Home Prices, Home Equity, and ARMs

Sometimes home prices rise rapidly, allowing people to quickly build equity in their homes. This can make some people think that even if the rate and payments on their ARM get too high, they can avoid those higher payments by refinancing their loan or, in the worst case, selling their home. It's important to remember that home prices do not always go up quickly—they may increase a little or remain the same, and sometimes they fall. If housing prices fall, your home may not be worth as much as you owe on the mortgage. Also, you may find it difficult to refinance your loan to get a lower monthly payment or rate. Even if home prices stay the same, if your loan lets you make minimum payments (see *payment-option ARMs* on page 33), you may owe your lender more on your mortgage than you could get from selling your home.

Prepayment penalties and conversion

If you get an ARM, you may decide later that you don't want to risk any increases in the interest rate and payment amount. When you are considering an ARM, ask for information about any extra fees you would have to pay if you pay off the loan early by refinancing or selling your home, and whether you would be able to convert your ARM to a fixed-rate mortgage.

Prepayment penalties

Some ARMs, including interest-only and payment-option ARMs, may require you to pay special fees or penalties if you refinance or pay off the ARM early (usually within the first 3 to 5 years of the loan). Some loans have *hard prepayment penalties*, meaning that you will pay an extra fee or penalty if you pay off the loan during the penalty period for any reason (because you refinance or sell your home, for example). Other loans have *soft prepayment penalties*, meaning that you will pay an extra fee or penalty only if you refinance the loan, but you will not pay a penalty if you sell your home. Also, some loans may have prepayment penalties even if you make only a partial prepayment.

Prepayment penalties can be several thousand dollars. For example, suppose you have a 3/1 ARM with an initial rate of 6%. At the end of year 2 you decide to refinance and pay off your original loan. At the time of refinancing, your balance is \$194,936. If your loan has a prepayment penalty of 6 months' interest on the remaining balance, you would owe about \$5,850.

Sometimes there is a trade-off between having a prepayment penalty and having lower origination fees or lower interest rates.

The lender may be willing to reduce or eliminate a prepayment penalty based on the amount you pay in loan fees or on the interest rate in the loan contract.

If you have a hybrid ARM—such as a 2/28 or 3/27 ARM—be sure to compare the prepayment penalty period with the ARM’s first adjustment period. For example, if you have a 2/28 ARM that has a rate and payment adjustment after the second year, but the prepayment penalty is in effect for the first 5 years of the loan, it may be costly to refinance when the first adjustment is made.

Most mortgages let you make additional principal payments with your monthly payment. In most cases, this is *not* considered prepayment, and there usually is no penalty for these extra amounts. Check with your lender to make sure there is no penalty if you think you might want to make this type of additional principal prepayment.

Conversion fees

Your agreement with the lender may include a clause that lets you convert the ARM to a fixed-rate mortgage at designated times. When you convert, the new rate is generally set using a formula given in your loan documents.

The interest rate or up-front fees may be somewhat higher for a convertible ARM. Also, a convertible ARM may require a fee at the time of conversion.

Graduated-payment or stepped-rate loans

Some fixed-rate loans start with one rate for one or two years and then change to another rate for the remaining term of the

loan. While these are not ARMs, your payment will go up according to the terms of your contract. Talk with your lender or broker and read the information provided to you to make sure you understand when and by how much the payment will change.

Where to Get Information

Disclosures from lenders

You should receive information in writing about each ARM program you are interested in before you have paid a nonrefundable fee. It is important that you read this information and ask the lender or broker about anything you don't understand—index rates, margins, caps, and other ARM features such as negative amortization. After you have applied for a loan, you will get more information from the lender about your loan, including the APR, a payment schedule, and whether the loan has a prepayment penalty.

The APR is the cost of your credit as a yearly rate. It takes into account interest, points paid on the loan, any fees paid to the lender for making the loan, and any mortgage insurance premiums you may have to pay. You can compare APRs on similar ARMs (for example, compare APRs on a 5/1 and a 3/1 ARM) to determine which loan will cost you less in the long term, but you should keep in mind that because the interest rate for an ARM can change, APRs on ARMs cannot be compared directly to APRs for fixed-rate mortgages.

You may want to talk with financial advisers, housing counselors, and other trusted advisers. Contact a local housing counseling agency, call the U.S. Department of Housing and Urban Development toll-free at 800-569-4287, or visit www.hud.gov/offices/hsg/sfh/hcc/hccprof14.cfm to find a center near you.

Newspapers and the Internet

When buying a home or refinancing your existing mortgage, remember to shop around. Compare costs and terms, and negotiate for the best deal. Your local newspaper and the Internet are good places to start shopping for a loan. You can usually find information on interest rates and points for several lenders. Since rates and points can change daily, you'll want to check information sources often when shopping for a home loan.

The Mortgage Shopping Worksheet may also help you. Take it with you when you speak to each lender or broker and write down the information you obtain. Don't be afraid to make lenders and brokers compete with each other for your business by letting them know that you are shopping for the best deal.

Advertisements

Any initial information you receive about mortgages probably will come from advertisements or mail solicitations from builders, real estate brokers, mortgage brokers, and lenders. Although this information can be helpful, keep in mind that these are marketing materials—the ads and mailings are designed to make the mortgage look as attractive as possible. These ads may play up low initial interest rates and monthly payments, without emphasizing that those rates and payments could increase substantially later. So, get all the facts.

Any ad for an ARM that shows an initial interest rate should also show how long the rate is in effect and the APR on the loan. If the APR is much higher than the initial rate, your payments may

increase a lot after the introductory period, even if interest rates stay the same.

Choosing a mortgage may be the most important financial decision you will make. You are entitled to have all the information you need to make the right decision. Don't hesitate to ask questions about ARM features when you talk to lenders, mortgage brokers, real estate agents, sellers, and your attorney, and keep asking until you get clear and complete answers.

Glossary

Adjustable-rate mortgage (ARM)

A mortgage that does not have a fixed interest rate. The rate changes during the life of the loan based on movements in an index rate, such as the rate for Treasury securities or the Cost of Funds Index.

Annual percentage rate (APR)

A measure of the cost of credit, expressed as a yearly rate. It includes interest as well as points, broker fees, and certain other credit charges that you are required to pay. Because all lenders follow the same rules when calculating the APR, it provides you with a good basis for comparing the cost of loans, including mortgages, over the term of the loan.

Balloon payment

A lump-sum payment that may be required when a mortgage loan ends. This can happen when the lender allows you to make smaller payments until the very end of the loan. A balloon payment will be a much larger payment compared with the other monthly payments you made.

Buydown

With a buydown, the seller pays an amount to the lender so that the lender can give you a lower rate and lower payments, usually for an initial period in an ARM. The seller may increase the sales price to cover the cost of the buydown. Buydowns can occur in all types of mortgages, not just ARMs.

Cap, interest rate

A limit on the amount your interest rate can increase. Interest caps come in two versions:

- *periodic adjustment caps*, which limit the interest-rate increase from one adjustment period to the next, and
- *lifetime caps*, which limit the interest-rate increase over the life of the loan. By law, virtually all ARMs must have an overall cap.

Cap, payment

A limit on how much the monthly payment may change, either each time the payment changes or during the life of the mortgage. Payment caps may lead to negative amortization because they do not limit the amount of interest the lender is earning.

Conversion clause

A provision in some ARMs that allows you to change the ARM to a fixed-rate loan at some point during the term. Conversion is usually allowed at the end of the first adjustment period. At the time of the conversion, the new fixed rate is generally set at one of the rates then prevailing for fixed-rate mortgages. The conversion feature may be available at extra cost.

Discounted initial rate (also known as a start rate or teaser rate)

In an ARM with a discounted initial rate, the lender offers you a lower rate and lower payments for part of the mortgage term (usually for 1, 3, or 5 years). After the discount period, the ARM rate will probably go up depending on the index rate. Discounts can occur in all types of mortgages, not just ARMs.

Equity

The difference between the fair market value of the home and the outstanding balance on your mortgage plus any outstanding home equity loans.

Hybrid ARM

These ARMs are a mix—or a hybrid—of a fixed-rate period and an adjustable-rate period. The interest rate is fixed for the first several years of the loan; after that, the rate could adjust annually. For example, hybrid ARMs can be advertised as 3/1 or 5/1—the first number tells you how long the fixed interest-rate period will be and the second number tells you how often the rate will adjust after the initial period.

Index

The economic indicator used to calculate interest-rate adjustments for adjustable-rate mortgages. No one can be sure when an index rate will go up or down. See the chart in the text for examples of how some common indexes have changed in the past.

Interest

The price paid for borrowing money, usually given in percentages and as an annual rate.

Interest-only payment ARM

An I-O payment ARM plan allows you to pay only the interest for a specified number of years. After that, you must repay both the principal and the interest over the remaining term of the loan.

Margin

The number of percentage points the lender adds to the index rate to calculate the ARM interest rate at each adjustment.

Negative amortization

Occurs when the monthly payments do not cover all the interest owed. The interest that is not paid in the monthly payment is added to the loan balance. This means that even after making many payments, you could owe more than you did at the beginning of the loan. Negative amortization can occur when an ARM has a payment cap that results in monthly payments that are not high enough to cover the interest due or when the minimum payments are set at an amount lower than the amount you owe in interest.

Payment-option ARM

An ARM that allows you to choose among several payment options each month. The options typically include (1) a traditional amortizing payment of principal and interest, (2) an interest-only payment, or (3) a minimum (or limited) payment that may be less than the amount of interest due that month. If you choose the minimum-payment option, the amount of any interest you do not pay will be added to the principal of your loan (see *negative amortization*).

Points (may be called discount points)

One point is equal to 1 percent of the principal amount of your mortgage. For example, if the mortgage is for \$200,000, one point equals \$2,000. Lenders frequently charge points in both fixed-rate and adjustable-rate mortgages in order to cover loan origination costs or to provide additional compensation to the lender or broker. These points usually are collected at closing

and may be paid by the borrower or the home seller, or may be split between them. Discount points (sometimes called *discount fees*) are points that you voluntarily choose to pay in return for a lower interest rate.

Prepayment penalty

Extra fees that may be due if you pay off the loan early by refinancing your loan or selling your home, usually limited to the first 3 to 5 years of the loan's term. If your loan includes a prepayment penalty, be aware of the penalty you would have to pay. Compare the length of the prepayment penalty period with the first adjustment period of the ARM to see if refinancing is cost-effective before the loan first adjusts. Some loans may have prepayment penalties even if you make only a partial prepayment.

Principal

The amount of money borrowed or the amount still owed on a loan.

For More Information

Looking for the Best Mortgage—Shop, Compare, Negotiate
(at www.federalreserve.gov/pubs/mortgage/mortb_1.htm)

*Interest-Only Mortgage Payments and Payment-Option
ARMs—Are They for You?*
(at www.federalreserve.gov/pubs/mortgage_interestonly/)

A Consumer's Guide to Mortgage Lock-Ins
(at www.federalreserve.gov/pubs/lockins/default.htm)

A Consumer's Guide to Mortgage Settlement Costs
(at www.federalreserve.gov/pubs/settlement/default.htm)

*Know Before You Go . . . To Get a Mortgage: A Guide to Mortgage
Products and a Glossary of Lending Terms*
(at [www.bos.frb.org/consumer/knowbeforeyougo/mortgage/
mortgage.pdf](http://www.bos.frb.org/consumer/knowbeforeyougo/mortgage/mortgage.pdf))

Partners Online Mortgage Calculator
(at www.frbatlanta.org/partnerssoftwareonline/dsp_main.cfm)

This information was prepared by the Board of Governors of the Federal Reserve System and the Office of Thrift Supervision in consultation with the following organizations:

AARP
American Association of Residential Mortgage Regulators
America's Community Bankers
Center for Responsible Lending
Conference of State Bank Supervisors
Consumer Federation of America
Consumer Mortgage Coalition
Consumers Union
Credit Union National Association
Federal Deposit Insurance Corporation
Federal Reserve Board's Consumer Advisory Council
Federal Trade Commission
Financial Services Roundtable
Independent Community Bankers Association
Mortgage Bankers Association
Mortgage Insurance Companies of America
National Association of Federal Credit Unions
National Association of Home Builders
National Association of Mortgage Brokers
National Association of Realtors
National Community Reinvestment Coalition
National Consumer Law Center
National Credit Union Administration

EXHIBIT B

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CERTIFICATION OF PROVIDING CHARM BOOKLET

To be completed by Borrower:

I have received the CHARM Booklet, which I may keep, and have had it for at least 24 hours before closing. I have read the CHARM Booklet and understand it.

Dated: _____

Borrower's signature

Borrower name (please print)

To be completed by 5280 Financial Group, Inc. or Troy Bowen

I hereby certify that I verified that the borrower has received the CHARM Booklet or, if not, that I provided it to the borrower at the time and date indicated below:

Delivered to borrower on:

_____ (date)

at _____ (time)

Signed on behalf of 5280 Financial Group, Inc. or Troy Bowen

Representative of 5280 Financial Group, Inc. or Troy Bowen

Print Name and Title

Date: _____